July 10, 2002

Honorable William Lyons, Jr.
Secretary of Agriculture
California Department of Food and Agriculture
1220 N Street
Sacramento, California 95814

Dear Secretary Lyons:

Land O' Lakes petitions the Department to hold a hearing on transportation credits and allowances. The reasons for the petition are explained in the next paragraph. We are petitioning to hold a hearing on both transportation credits and allowances, which would require a hearing both in milk pooling and in milk stabilization. We hope that serious consideration will be given to these proposals.

There have been significant changes in the structure of the dairy industry in California in the last couple of years. From a firm standpoint, the processing industry has become significantly more concentrated. But, one factor has not changed and that is that significant amounts of milk are moved from the South Valley into Southern California. But, there is also a troublesome trend. A much larger proportion of the milk is now supplied by out-of-state sources and starting on August 1, 2002, the proportion of milk supplied from out-of-state sources is increasing dramatically. This means that additional amounts of Class 1 sales are being serviced from outside the state of California. Does this trend threaten the continued existence of the statewide pooling system? I think it does. It is appears that the milk from the South Valley is not competitive with milk from out of state sources in supplying Class 1 needs in Southern California. In our opinion, this should not be the case and there is something that can and should be done to correct this problem. Our proposal is to adjust the transportation credit from the South Valley to Southern California, to expand the transportation allowances from the South Valley to Southern California and to expand the transportation allowances for local milk in Southern California.

Proposal number 1: Adjust the transportation credit from 50 cents to 64.0 cents for milk shipped from Tulare County to Riverside County and to San Diego from 50 cents to 56.5 cents for milk shipped from Tulare County to LA county, Orange County or Ventura Counties. There has usually been a shortfall in moving milk on a plant-to-plant basis from the South Valley to Southern California. Our proposal would maintain the concept of a shortfall. But, we are recommending a shortfall of 5 cents per cwt. Today, the shortfall from Tulare to Riverside County is 19.0 cents and that is the largest shortfall in history for moving milk on a plant-to-plant basis from the South Valley to Southern California. We, of course, recommend that the area differential be maintained at 27 cents per cwt between Northern and Southern California.

The specific language would be as follows:

Section 300.2. Each handler located in counties designated herein as a supply county may deduct from the applicable minimum prices pursuant to Section 300.00, paragraph (A), a transportation credit for quantities of market milk and market skim milk shipped in bulk form to a plant located in a designated county. Shipments of condensed skim milk and cream are excluded from such transportation credits. Such deduction shall not exceed amounts shown for such bulk transfers in the following schedule:

	Maximum Deduction Per cwt	For Shipments to Designated Deficit Counties
Tulare County	$.**64**	**Riverside**
Tulare County	$**.565**	Orange, Los Angeles or Ventura Counties
Fresno County	$.**67**	**Riverside**
Fresno County	$**.595**	Orange, Los Angeles or Ventura Counties

The remainder of the transportation credits would remain unchanged.

Proposal 2. To make California more competitive with out-of-state sources and to provide more producer equity, we are recommending three important changes in the transportation allowance. One is to limit the transportation allowances to plants that process more than 50 percent of the total pounds of milk processed at the plant location into products other than products classified as Class 4a and Class 4b, excluding condensed skim and cream. Two is to expand the transportation allowance to Riverside County and the third is to reduce the mileage bracket for local milk in Southern California to attract the milk for Class 1 usage. The problem is that traffic tends to be very heavy into the Class 1 plants in metropolitan areas. It is often easier and less expensive to deliver milk to a nearby manufacturing facility. The transportation allowance in this case is meant to remove the disadvantage of serving Class 1 plants in metropolitan markets. However, the transportation allowance should be available only to producers who have the option of shipping their milk to a manufacturing facility.

Section 921. Producers, including producer-members of cooperative associations, will receive transportation allowances on shipments to plants which are located within designated areas and which, during the immediately preceding 12-month period actually processed more than 50 percent of the total pounds of milk processed at the plant location into products other than Class 4a or Class 4b (**excluding condensed skim)**. For purposes of this section, a "plant" includes one of more pool plants under single ownership within a designated area.

For plants located in the Southern California receiving area which shall consist of the counties of Los Angeles, Orange, Ventura and **Riverside**:

(1) From Imperial, Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, San Diego and Ventura counties the transportation allowances will apply if producers have the alternative of shipping milk to a nearby manufacturing facility and it will apply to producers located in Fresno, Kern, Kings and Tulare Counties:

(From 20 through 40 miles)	**$.05 per CWT**
Over 40 miles through 89 miles	**$.10 per CWT**
Over 89 miles through 139 miles	$.43 per CWT
Over 139 miles **through 200 miles**	$.58 per CWT
Over 200 miles	**$.62 per CWT**

Justification for the proposals:

1. One of the reasons for the adjustments in the transportation credits and the transportation allowance is to make California milk more competitive with out-of-state sources. There are certainly adequate amounts of milk available to meet the Class 1 needs in this state. These adjustments do not guarantee that out-of-state milk no longer will be imported. But, these adjustments help to make California sources to be more competitive. A second reason is producer equity. A producer should not incur higher costs to move milk to a Class 1 plant than to a local manufacturing facility.
2. There is a need for more than a single transportation credit makes sense because it is much easier to achieve equal raw product costs among firms if the transportation credit is applied in two locations. It simply costs more to move milk from the South Valley into Riverside County than it does from the South Valley into Los Angeles, Orange or Ventura Counties.
3. The use of more than one transportation credit is in accord with what is being done in Federal order markets. The Federal order markets that use the transportation credit use the mileage from the supply plant to the Class 1 plant wherever it is located. That concept has logic. In fact, we are recommending one transportation credit from Tulare to Riverside County and another transportation credit from Tulare to Los Angeles, Orange and Ventura Counties.
4. The transportation credits would maintain a shortfall of 5 cents to encourage local milk to be used first.
5. One of the advantages of moving milk on a plant-to-plant basis from the South Valley is that the milk can be tailored to match the utilization of fat and solids not fat in milk used for Class 1 purposes. In fact, most of the milk moved to Southern California from the South Valley on a plant-to-plant basis has been tailored milk. The tailoring of milk avoids to costly process of separating the milk into skim and

into cream in the Southern California bottling plant and from shipping surplus cream from Southern California to the South Valley for processing such cream into butter.

6. Economic theory supports the concept that price differences in milk reflect costs of transportation when moving milk from surplus to deficit markets. In California such costs of transportation are compensated for through the use of transportation allowances and credits.
7. From a historic standpoint, California has always had an area differential or a combination of an area differential and a transportation credit to reflect the cost of moving milk from surplus producing areas to deficit markets. The same is true in Federal order markets.
8. Land O' Lakes has served customers in Southern California for 50 years or more. Land O' Lakes has been meeting its commitment to serve the Class 1 market and they have done that for years.
9. The transportation allowances should be expanded to local milk in Southern California because it simply costs more to move the milk into the traffic into the Class 1 markets than it costs to move the milk into some local manufacturing plant. This concept will encourage the local milk to move into the highest and best use. The current system actually encourages the movement of milk into a local manufacturing plant.
10. The expansion of the transportation allowance into Riverside County also makes sense. There is a significant amount of milk moved in from out-of-state sources into Riverside County. The use of the local transportation allowance in Southern California and the expansion of the transportation allowance from the South Valley into Riverside County simply make the California sources more competitive with out-of-state milk.
11. A transportation allowance should not be used to indirectly move milk from the South Valley into a cheese plant. The exclusion of condensed skim in determining the eligibility of the recipient plant in the transportation allowance system should help to curb this problem.

We urge that the Department call a hearing on these important issues. Thank you.

Sincerely,

James W. Gruebele
Consultant for Land O' Lakes

CC: Kelly Krug
David Ikari
Bob Horton